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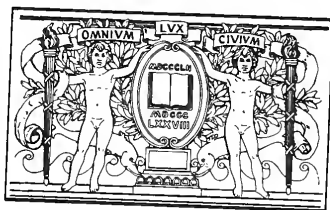
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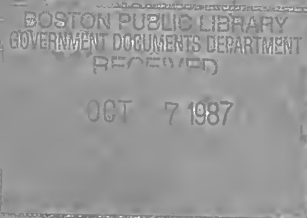
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CITY OF BOSTON
FINANCE COMMISSION

294 WASHINGTON STREET
SUITE 817
BOSTON MA 02108
TEL 482-9706



John L. Tobin, Esq., Chairman
George Huggins
Jack E. Molesworth
Sean Mullin
Dennis Quilty, Esq.

Jeffrey W. Conley
Executive Director

June 30, 1987

AN INVESTIGATION OF THE PERFORMANCE OF CABLEVISION
OF BOSTON AND THE PROPOSED AMENDMENTS TO THE
BOSTON CABLE TELEVISION LICENSE



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June 29, 1987

The Honorable Raymond Flynn
Mayor of Boston
City Hall
Boston, MA 02201

Dear Mayor Flynn:

Enclosed please find the Finance Commission's report on Cablevision of Boston's performance under its license agreement with the City of Boston as well as our recommendations on the proposed amendments to said agreement. This report will be released to the City Council and the media shortly.

It is our hope that this report along with the city's recent performance evaluation of Cablevision will assist you in reviewing the proposed amendments and help you secure the most beneficial agreement to the City as well as improved service for its residents.

Sincerely yours,

John L. Tobin
Chairman
Finance Commission

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INTRODUCTION

On December 15, 1982 the City of Boston officially entered the cable era with the grant of a final cable television license to Cablevision of Boston (Cablevision).¹ Under the detailed terms of the license, Cablevision committed itself to constructing, operating, and managing a state-of-the-art cable system for Boston subscribers.

The license was granted as the culmination of an intensive review process which began in August, 1980 when the City solicited applications for the license. It issued a Request for Proposals (RFP) which outlined its goals and set forth specifications for the construction and operation of the cable system.

In response, nine companies submitted proposals to the City. After careful review, the City selected Cablevision to receive the license. The company appeared to possess the necessary resources, expertise, and experience to translate the ambitious promises contained in its Proposal and the license into reality.

Today, four-and-a-half-years later, this promising beginning has been tempered by the reality of intervening events. As demonstrated by this report, Cablevision has failed to comply with many of the material terms of the license it executed in December, 1982. Most significantly, the system itself is not fully constructed. Additionally, in the areas of rates, programming, service,

¹ Cablevision of Boston is a limited partnership comprising two general partners and a group of 525 limited partners. The two general partners are Charles Dolan and Cablevision Systems Boston Corp., a Mass. Corporation fully owned by Dolan. Dolan is also the full owner of Cablevision Systems Service Corp., a New York Corporation with which Cablevision of Boston has a management services contract.

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and payments to the City and the City's Access Foundation, among others, Cablevision has fallen short of the obligations it undertook by executing the license.

Furthermore, in contrast to the bright financial picture Cablevision painted when it sought the license, the company has been plagued by financial woes. It attributes its failures to-date to its precarious financial situation, and has proposed numerous revisions to the license in order to help rectify this situation. The City has also proposed certain amendments and both sets of amendments are under discussion and consideration at the present time.

Meanwhile, Cablevision remains in violation of certain license terms. The City has not pressed Cablevision for full compliance, nor has it asserted remedies available to it under the license for noncompliance.

It is within this setting that the Boston City Council requested the Finance Commission to investigate the performance of Cablevision. The Commission asked Mayor Raymond L. Flynn to withhold any decision on the proposed amendments to the license until the Commission could complete its investigation and this Report and the Mayor honored this request.

The Commission's investigation has focused on Cablevision's performance as the City's cable television licensee since it was awarded the license on December 15, 1982. In particular, the Commission has reviewed the representations and promises which Cablevision made when it introduced and presented its proposal to construct and maintain a cable television system in Boston. The Commission has reviewed the obligations which the company assumed when it executed the License Agreement as to the type of system and service which it agreed to provide the City. The Commission has compared these promises and obligations with Cablevision's actual performance to determine where significant disparities lie. Finally, the Commission has evaluated the

respective proposals to amend the License Agreement in the context of this review of Cablevision's performance to-date, and has made recommendations for appropriate action.

SUMMARY OF FINDINGS

The Commission has found in certain areas a substantial gap between what Cablevision promised the citizens of Boston in order to obtain the City's cable license, and what it actually delivered. This gap between promise and performance manifests itself most vividly in the following areas:

1. Construction - Whereas Cablevision promised to complete the entire cable system by December, 1985, four neighborhoods remain without cable service today.

2. Rates - Whereas Cablevision promised to freeze Basic rates for five years, it has chosen instead to utilize a legal loophole to raise rates after four years and thereby ignore that promise. Furthermore, whereas the company made the universal availability of low-cost Basic Service a cornerstone of its Proposal to the City, it has now denied new customers (including those in unbuilt neighborhoods) the opportunity to purchase that service. It further plans to eliminate the current Basic Service effective January 1, 1988.

3. Programming - Whereas Cablevision guaranteed that its low-cost Basic Service would comprise 52 channels for 5 years, it cut that number to 29 channels after 3 years, thereby impairing the breadth and variety of programming available to Basic subscribers.

4. Service - Whereas Cablevision touted its customer service as an important basis on which it should be selected as the City's cable licensee,

since obtaining the license the company's customer service has been plagued by delay, inefficiency, and ineptitude.

5. Access - Whereas Cablevision pledged to support the City's Access Foundation at the rate of 5% of its annual gross revenues, it later persuaded the Foundation to slash that figure by more than 50%.

6. Finances - Whereas Cablevision emphasized its financial strength and stability in the Proposal stage, and promised to infuse \$30million of equity into the Boston operation, in fact the company provided little financial support for four years after the license was awarded. Instead, the company relied on the sale of limited partnership interests and bank loans to support the system. Direct support from the parent company came only after the limited partner sales were completed, and were too little and too late to surmount the severe financial difficulties which were already draining the system.

6. Franchise Fee - Cablevision has failed to pay approximately \$1million to the City in 1986 and 1987 in franchise fee payments.

The Finance Commission believes that any amendments to the license must be considered in the context of these failures by Cablevision and should be aimed in large measure at ensuring Cablevision's future compliance with the obligations it undertook in the license. Such amendments should also consider Cablevision's present financial situation, the ability of the parent company and its affiliates to enhance their support for the Boston operation, and the magnitude of the concession the company has already received by virtue of the Access Foundation agreeing to a substantial reduction in the company's annual contribution. Finally if the City is to make concessions, it should extract from Cablevision reciprocal concessions to protect the City's subscribers. Cablevision has left in its wake a trail of broken promises to Boston

subscribers. This record cannot and should not be ignored by the City in negotiating any amendments to the license.

I. CABLEVISION PERFORMANCE

The question of Cablevision's compliance with the terms of its license is important to consider while entertaining any amendments. The City has the responsibility to monitor the performance of Cablevision and see to it that the license is enforced. The Finance Commission has reviewed Cablevision's performance in certain key areas for the past several years.

A. Construction

1983 Cablevision had a 3 and 1/2 year construction schedule as set forth in Section 3.2 of the license and it exceeded that schedule, constructing more than 1/3 of the system in its first year. There were problems with contractors entering private property without access agreements but overall it was a good first year.

1984 Construction again proceeded well with Cablevision exceeding its schedules. Chinatown, however, was not built as scheduled and as promised by Cablevision at the 1983 performance hearing. The company became involved in a dispute with the Back Bay Architectural Commission (BBAC) concerning wiring methods in the Back Bay. For a second straight year there were numerous complaints about accessing private property without permission.

1985 Some work was done in multiple dwelling units in the Fenway area but construction nearly ground to a halt. Four neighborhoods remained unbuilt although the Back Bay was still being held up by the Back Bay Architectural Commission. Cablevision cited financial problems as the reason for the delay.

1986 A minimal amount of work was done on multiple dwelling units but nothing in the four neighborhoods still without cable service. The company was again in default of license requirements.

1987 Nothing has changed to date this year except that in March Cablevision and the BBAC reached an agreement on construction plans.

B. Rates

Cablevision's offer of a \$2 basic service guaranteed for a period of five years was one of the principal reasons it was awarded the Boston license. (License, Schedule 2). Cablevision's formal proposal to the City was even more ambitious, stating "(w)e intend to maintain the \$2 monthly charge --or even lower it--throughout the life of the franchise." Company Vice President Garofano testified at the public hearings held prior to the award of the license that "Cablevision will guarantee its rate. In fact Cablevision has never, never, ever in the history of the company raised its basic rate and we will stick to that promise in Boston, that's a commitment."

It was, however, a commitment which was not kept. Under the license, the rate for Universal Basic Service was required to be maintained for five years after the date of "system activation." While the license does not define "system activation," it obviously could have been no earlier than the date the license was granted to Cablevision, December 15, 1982. Thus, Cablevision was prohibited from raising the rate until December 15, 1987 at the very earliest. But Cablevision jumped the gun by nearly a year. The rate for Basic Service was increased to \$6.25 effective January 1, 1987.

1984 All rates except Basic Service increased effective December 1, 1984. The City was especially concerned that subscribers were being unfairly charged \$30 to downgrade.

1987 The rate for Basic Service increased to \$6.25 effective

January 1, 1987. Rates for the Metro, Family and Rainbow services were also increased.

1988 The company has notified the City that Basic Service, as it exists

currently, will no longer be offered as of January 1, 1988.

C. Programming

Another major factor in Cablevision's receiving the Boston license was its commitment to provide a 52-channel Basic Service guaranteed, like the basic rates, for five years. (License, Section 6.2 and Schedule 7). Company President Charles Dolan repeatedly stressed the quality of his programming during the hearings process. Cablevision assured the City that its programming was extensive and included, in addition to all local programming, most of the superstations, ESPN, USA, Nickelodeon, CNN, C-Span, and a host of others.

This was another commitment which was not honored, however. In 1983, its first year of operation, Cablevision notified the City that it intended to drop ESPN, USA, and CNN from its Basic programming. Then-Mayor White advised the company that such action would violate the license provision requiring 52-channel Basic programming, and insisted that Cablevision comply with the provision. Cablevision then backed down from its plan and kept the 52-channel programming in place.

However, on November 1, 1985, less than three years after the license was signed, the company reduced the Basic programming from 52 channels to 29, thereby disregarding its commitment to maintain the 52-channel low cost Basic Service for five years. Cablevision provided the City with evidence that its programming costs increased in defense of its decision. Having reduced the Basic programming to 29 channels, the company then created a new metro tier of

service comprising the old Basic 52 channel format, plus added Sportschannel. It offered this service at \$6.25 per month for existing subscribers and \$12.50 for new subscribers.

D. Customer Service

Cablevision's Proposal to the City emphasized that the company had an excellent track record in operating cable systems. As part of that record, the company stated in the Proposal (p.4): "Cablevision's customer service record is unparalleled, with the fastest response time in the industry and round-the-clock maintenance crews.

Perhaps in no other aspect of its operation was there a more yawning gap between Cablevision's promise and its performance. In Cablevision's first year of operation, 1983, the City received thousands of complaints from subscribers who were not even able to get through to the company by telephone in order to lodge service complaints.

1984 Customer service was referred to as "out of control" by the City in 1984. Mayor Flynn had to call in Charles Dolan to try and have him personally intercede to improve customer service. There were 33,000 billing complaints and 350 complaints about no-show installation visits.

Things were so bad that the Attorney General threatened a suit against the company for violating Mass. General Laws Chapter 93A, the State Consumer Protection Act, which prohibits companies from engaging in unfair or deceptive practices which injure consumers. Under the provisions of section 5 of the Act, the Attorney General asserted that certain of Cablevision's practices relating to service were unfair and deceptive practices, while Cablevision denied this

allegation. Nonetheless, Cablevision agreed to reform these practices in an Assurance of Discontinuance signed by the Office of the Attorney General and Charles Dolan on May 15, 1984. The Attorney General accepted this agreement in lieu of suing the company.

Despite a letter from the Attorney General to Cablevision in October, 1984 in which the Attorney General expressed its satisfaction with the company's response to consumer issues. The Commission's investigation and the City's annual performance appraisals revealed a pattern of continuing violations of the Assurance of Discontinuance, particularly relating to customer service during the period 1984 to the present.

1985 Despite the agreement to improve customer service management, it remained a serious problem. Over 14,000 billing complaints were received by Cablevision. Over half of all calls were unanswered. Visits to homes for service calls were missed on hundreds of occasions. There was improvement by the end of 1985; however, overall compliance was poor and neither the City or the Attorney General sought action due to the failure of the company to meet the terms of the 1984 Assurance of Discontinuance .

1986 There was improvement in customer service although it was still not at an acceptable level.

1987 People continued to have trouble reaching the company by phone. The Finance Commission checked the customer service telephone over the past month. We found lengthy waits to get through. Out of the 62 calls made only 16 were answered in less than 2 minutes, the number cited by the company as its average response time. We waited 25 minutes on hold on one occasion and the average on-hold time was 7 minutes which is not acceptable. The new telephone system, activated in early June, should improve performance although we found that calls are being lost at the present time.

E. Franchise Fee

Cablevision also proposed a financial commitment to the City in the form of a franchise fee to be paid by Cablevision every six months. Vice President Sheila Mahony, for example, stressed the Company's commitment to give "3% (of gross revenues) to the City unconditionally," a commitment which was incorporated into the license (section 8.1 and 8.2).

This commitment lasted three years. Cablevision paid the required fee in 1983, 1984, and 1985. In 1986, beset by financial problems, the company missed both payments, totalling approximately \$650,000. Cablevision also failed to make the payment for the first half of 1987, which should have amounted to approximately \$350,000 - 375,000. Thus, Cablevision currently owes the City approximately \$1,000,000, plus interest, in missed fees.

F. Access Foundation

Another important factor in the City granting Cablevision the license was its commitment to supporting the Boston Community Access and Programming Foundation, Inc. ("The Foundation"). The Foundation is an independent, nonprofit corporation created to assure the right and ability of Boston citizens to use facilities, equipment, and channels of the cable system constructed by Cablevision.

Company President Charles Dolan testified at the public hearings on Cablevision's applications for the license that "we pledge to give 5% of gross revenues throughout the entire length of the franchise to the Access Corporation." Vice President Sheila Mahony echoed this pledge, telling City officials "we have absolutely committed 5% of gross revenues to the Access

Corporation ..." This pledge was incorporated into the license, section 11, which required Cablevision to execute a contract with the Foundation under which Cablevision would pay the Foundation five per cent of its gross revenue, build five studios (three neighborhood and two downtown) for use by local citizens and groups, and provide equipment.

After signing the agreement with the Foundation, Cablevision once again failed to live up to its commitments.

1983 The payment was made to the Access Foundation but no studios were built. There were no Public Institutional Network drops and Cablevision was slow in providing vans and equipment to the Foundation.

1984 Payment was made again and the Roxbury studio was in operation. The license however, required three neighborhood and two downtown studios. Cablevision did nothing about building the other neighborhood studios. Cablevision provided no additional time for the Foundation at the Roxbury studio despite agreeing to do so. It also failed to co-sign a contractually agreed to loan.

1985 Cablevision did not meet its financial commitment to the Foundation. It arbitrarily paid \$30,000 per month for two months then renegotiated a new agreement with the Foundation replacing the 5% of gross with set monthly payments through the duration of the contract. The new agreement reduced Cablevision's financial commitment by 50%. Still only the one studio was in operation.

1986 Cablevision had only the one studio for the Access Foundation.

1987 No change.

G. Commercial Institutional Network (CIN)

The CIN is a single trunk bi-directional network which was to parallel the trunk of the subscriber network citywide. It is to offer a range of interactive services.

1983 The company researched the CIN but no construction was begun.

1984 No construction of the CIN took place, a violation of the license which required it to be built city-wide. The company suggested that it might consider building it in the downtown area.

1985 Nothing was done.

1986 Nothing was done.

1987 Nothing was done.

H. Public Institutional Network (PIN)

The PIN is a single trunk bidirectional network to be reserved for use by public institutions throughout the City. The PIN is to be capable of offering a full range of interactive services.

1983 There were only 10 PIN connects.

1984 Much more was done with five city departments actively engaged in an information network. The Access Foundation had 5 projects, one in operation. Installation was slow and restricted geographically.

1985 No PIN drops were made for the Access Foundation.

1986 250 miles of PIN cables were active at year's end.

1987 Only minimal work to date.

I. Leased Channels

Leased channels are those available to be leased by people other than the licensee as required in section 6.12 of the license.

1983 Cablevision was charging too much money, \$1,500 per hour, thereby discouraging use and was so advised by the City.

1984 The situation worsened as Cablevision was charging \$1,650 per 30 minutes for part-time users and \$725 per hour for full time. The cost was preventing leased access opportunities.

1985 Same as 1984.

1986 One channel was leased and the company was again advised by the City that its cost prohibited reasonable use of leased channels as provided by section 6.12 of the license.

J. Two-Way or Interactive Service

Interactive service is one which provides subscribers the capability of transmitting and receiving signals. Cablevision originally was required to offer subscribers two-way interactive converters on or before June 1, 1983.

1982 Almost immediately the provision for the two-way service was amended, which reduced the company's obligation to install 1500-2000 two-way converters by December 31, 1983.

1983 Cablevision failed to honor the amended agreement reached just the previous year.

1984 The converters were not installed as per agreement. Fewer than 1000 were installed. Cablevision failed again to meet even the amended terms characterized in the 1984 performance evaluation as a "generous" agreement by the City.

1985 Cablevision made some improvements activating a number of neighborhoods. This was its most productive year in developing the interactive service.

1986 Pay-per-view programming was offered as an interactive service either on a per-event basis or on monthly discounts.

K. Initial Service

1983 The company was not complying with the provision of section 6.1 of the license that all customers receive cable service within 14 days of paying for it.

1984 There were continued complaints on this issue, serious enough to be made a part of the Assurance of Continuance agreement reached between Cablevision and the Office of the Attorney General.

1985 Cablevision agreed at the 1984 performance hearing to provide free installation if it missed the original appointment. It did not abide by that instead providing free installation if it missed two appointments. It provided over 3,000 free installations.

1986 Missed installation visits remained a problem.

L. Employment and Training

1983 Cablevision has some problems with its subcontractors but was in full compliance with employment numbers set forth in section 13 of the license.

1984 Again, Cablevision was in compliance with its license requirements. It had problems meeting the percentage of minority based firms in its procurement practices with only 1% as opposed to the required 10% of such firms being utilized.

1985 Cablevision again did well in terms of employment requirements and had an excellent training program for employees.

1986 Continued to be in compliance.

1987 Cablevision remains in compliance and even exceeds the standards for Boston residents, minority and women employees.

M. Boston Housing Authority Construction

1983 The company was well behind schedule wiring BHA units.

1984 9,000 of the 15,000 BHA units were wired.

1985 Minimal progress with less than one thousand added units wired.

1986 Only 139 units wired this year leaving thousands without service.

II. FUTURE RATE REGULATION

The deregulation of cable rates has complicated certain provisions of the license and the amendment process. A low cost Basic Service, guaranteed for five years, was the foundation of the license agreement. Cablevision maintained the \$2 monthly rate for four of the five years. It was increased to \$6.25 per month effective January 1, 1987 for current subscribers and this service at this cost is not available at all to new subscribers. Effective January 1, 1988 Cablevision has announced that it will no longer offer Basic Service to any subscriber.

Under the Cable Communications Policy Act of 1984, 47 U.S.C. section 543 (the Cable Act), where a franchise, such as Boston's, was already in effect prior to the effective date of the Act (December 29, 1984), then for a two-year period (until December 29, 1986) the franchising authority (here, the Mayor of

the City) could regulate the rates for "basic cable service, including multiple tiers of basic cable service." 47 U.S.C. section 543(c). After December 29, 1986, rate regulation for basic rates is permitted only in areas where there is not adequate competition. While the precise parameters of this standard are a matter of some controversy at present, it is likely that Boston, as a large urban center within easy range of numerous local broadcast signals, would not be considered such an area. Hence, rate regulation of Cablevision by Boston is banned after December 29, 1986.

Two subsidiary legal questions remain in light of this deregulation provision. First, what is the status of the rate freeze provision in the license? Secondly, can the city exact from Cablevision a legally binding commitment as to future rates in the amendment process?

Regarding the rate freeze provision, Cablevision has violated its terms by raising rates which were voluntarily agreed to by Cablevision in executing the license agreement. This is not the imposition of the City's will or authority on the company, but rather a mutual agreement which both parties viewed as being to their benefit to make.

The issue of rate regulation is currently before the Massachusetts Appeals Court in Town of Norwood, et al. v. Adams-Russell Co., Inc., No. 87-375, presently awaiting a date for oral argument. The City should watch this case closely. If the Appeals Court were to rule that a rate freeze provision is not "rate regulation," the City should consider seeking enforcement of that provision.

The second question is whether the City can exact from the Cablevision a binding commitment as to future rate increases in the course of the process of amending the license. The Commission believes that such concessions should be

part of the package to which Cablevision must agree in order for it to obtain concessions.

The Commission believes that in order to assure the legal validity of any such provision in light of the above-referenced deregulation provisions of the CCPA, the City should insist that Cablevision sign an agreement in which it explicitly states that the rate concessions are freely and voluntarily entered into by it in consideration for benefits conferred on it by the City, that the rate provisions do not constitute rate regulation under the CCPA, that the City is not thereby regulating its rates, that to the extent such provisions are construed to constitute rate regulation Cablevision expressly waives any protections or rights afforded by the CCPA, and agrees not to raise it as a defense to enforcement of the provision. If it raises such a defense, Cablevision would agree that the benefits it received in consideration therefor would be deemed null and void, and superseded by the original license provisions pertaining thereto.

III. Office of Cable Communications

The Office of Cable Communications comes under the jurisdiction of the Administrative Services Department and is responsible for monitoring the license with Cablevision. The Cable Office is also required under section 14.1 of the license to hold an annual performance evaluation hearing. The Cable Office then publishes its findings. The Commission has reviewed all of the evaluation reports including the 1986 report released on June 24, 1987.

The first report in 1983 was issued on December 27, 1983 in a timely fashion. The 1984 report was issued in mid-March, 1985. The 1985 report was issued in mid-March of 1985 and the 1986 report issued just last week. The

1986 performance evaluation actually considered many 1987 issues. The continued late submissions of the reports lessens the value of each. Even though the evaluations are detailed and point out license provisions which were not complied with, the city has not used the reports to require performance where it was a documented problem.

IV. CABLEVISION FINANCES

It should be noted at the outset that there were early warning signals concerning Cablevision's financial projections which both the City and Cablevision chose to ignore. A consultant, Malarkey Taylor, warned the City about certain overestimates on the part of Cablevision. Cablevision estimated that the penetration rate would exceed 70% and that subscribers would spend an average of \$43 monthly on cable tv. Both estimates exceeded industry standards by substantial margins and were regarded by the City as unreachable.

City officials questioned Cablevision President Charles Dolan about his firm's estimates during the public hearing. Dolan responded, "If we stumble at the beginning and something is wrong, if we haven't analyzed this market correctly, I think that we have more than enough management capacity to back and look at the problem, fix it, and bring penetration levels back up. The 50% level we would be able to tolerate without any problem. We could go much below that."

Cablevision has attributed its inability to meet the terms of its license to financial troubles. The company claimed it was unable to extend lines of credit and thus could not complete construction or meet other provisions of the license that required the expenditure of funds. City officials did not accept Cablevision's claims and Collector-Treasurer George Russell conducted a financial review of Cablevision in March, 1985. The

Finance Commission found this review to be a concise and accurate assessment of the financial state of the company at the time.

Russell concluded that overall, the system was doing well, that penetration rates and average revenue per subscriber were above industry standards. The problem was in the manner in which the system was financed. Cablevision is a highly leveraged operation in which owner's equity amounted to \$14.2 million against a total debt of \$98.8 million by September, 1984. The bank debt carried heavy interest payments which put a severe strain on cash flow requirements.

This financial structure used by the company differed significantly from what Cablevision had proposed. The accelerated construction schedule was designed to follow the infusion of funds from the limited partners and result in an earlier return cash flow by bringing service to more areas more quickly. It did not work as well as Cablevision had expected. Its marketing strategy did not adequately keep up with construction. Too many multiple dwelling units had access problems because the company did not reach access agreements with property owners.

Cablevision's acquisition of the Brookline system in 1983 adversely affected the Boston franchise. It diverted approximately \$10,000,000 of funds that could have been committed to Boston.

The Collector-Treasurer concluded that the financial success of Cablevision did not rest on concessions being granted by the City. He pointed out that such concessions substituted taxpayers money for bank loans and suggested that Cablevision recapitalize by taking several actions including:

1. Selling the Brookline system or reconfiguring its ownership structure;
2. Increasing the equity contribution of Charles Dolan;

3. Reducing, as well as continuing to defer, the percentage of gross proceeds going to management concerns;

The Collector-Treasurer pointed out that whatever sacrifices were needed should come from those who benefitted the most from the financing plan.

The Finance Commission has reviewed more current financial records and accounting reports of the company. Our conclusions parallel those of the Collector-Treasurer. Cablevision did not finance the system in the manner which it originally proposed.¹ It relied heavily on the funds from its limited partners and bank loans.

The Finance Commission analyzed the 10-K reports (Annual reports filed with the Securities and Exchange Commission pursuant to the Securities Exchange Act of 1934) filed by Cablevision from 1982 through 1986. They do not give the complete picture of company finances, especially the amount of interest accrued by the company and owed to other related affiliated companies. The Commission sought much of the supporting data to these reports in order to identify the exact nature of all expenses, what constituted partners preferred equity, interest charges and payments among many other questions. Cablevision officials wanted assurances from the Finance Commission that we would keep certain financial records confidential, a request we could not honor. As a result, the company did not provide all the financial information that was requested. Company officials did, at the last minute, provide some verbal responses.

The selected financial data identifies net operating losses of \$27.3million in 1986, \$26.9million in 1985 and \$13.8million in 1984. The Commission wanted specific financial information identifying all expenses as

¹ Charles Dolan testified at the public hearing that, "We have specified a financing plan which is \$30million equity, \$30million fixed-rate long term money and \$30million debt."

well as an itemization of depreciation and amortization which led to those numbers. We also sought information identifying the debt position of the company. Referring to the consolidated balance sheet, the Commission sought information on liabilities and partners' deficiency items. Because Cablevision is owned and controlled by Charles Dolan, as are all of the Cablevision entities, the cost of transactions between those companies is important to consider in relation to the stated financial position of Cablevision. Debt service was a cost which the Commission believed necessary to give the overall financial picture.

The 1986 year produced gross revenues of \$25,986,000 but a net operating loss of \$27,284,000. Two main factors contributed to the loss. Interest payments were \$13,545,000. Some of that interest, we could not determine how much, was payable to related Cablevision's affiliates. Depreciation and amortization of \$16,229,000 was charged as an operating expense, certainly a legitimate accounting procedure but misleading to some extent. Actual operating expenses were broken down in two areas; technical expenses were \$8.8million of which \$6.2 were affiliated amounts and selling, general and administrative expenses were \$13.9 million, of which \$5 million were affiliated amounts.

The company's financial position at present is a problem. However, it is not due to any action on the part of the City. The company borrowed substantial sums of money to construct the system and found that revenues were less than expected. The interest payments are high and are a substantial portion of what the company refers to as its operating expenses. Cablevision has been advanced funds described as partners preferred equity. Those funds have been provided for a variety of reasons; the repayment of some loans and generally paying for certain costs associated with financing the business. Cablevision, however, pays interest on advances made to it and accrues interest

on all unpaid fees. Again, such interest payments and accruals benefit affiliated companies of Cablevision.

The company's financial plight is due to its own financing and management problems. Certainly if partners equity had been infused into the Boston franchise along with, and at the same time as, bank loans and the contributions of the limited partners, then the financial position of the company would be different. The substantial amounts of interest being paid as well as that accrued and payable to other Cablevision affiliates would be much less. The taxpayers of the City cannot be expected to pay for the manner in which Cablevision chose to finance the construction and operation of the cable system particularly when there is a variance with what was originally promised.

V. PROPOSED AMENDMENTS TO LICENSE

Charles Dolan sought some changes in the license due to the financial problems of the company and put his concerns in writing to the Director of Administrative Services, Raymond Dooley, in a letter dated September 11, 1985. In return for completing construction and trying to maintain some type of agreeable fee for basic service, Dolan wanted the City to consider the financial realities of the cable industry. He wanted the franchise fee reduced from 3% to 1% of gross revenues. He asked that certain license requirements, which he claimed were no longer practical, be eliminated and that future investment for capital facilities be postponed until cash flow improved. He also wanted to eliminate the provisions of a local bond offering, required in section 10(d) of the license, as a way to raise revenues.

Dooley responded, in a letter of October 25, 1985, offering the quid pro quo necessary for any agreement: agreement on a low cost basic service through the end of the license in 1997, programming agreements and management improvements in the customer service area. A prime need was completing construction of the system. Dooley suggested a deferral of the license and a discussion of the following issues: interactive services, technical specifications, head end requirements and the mini-bonds (a financing provision which offered Boston residents and businesses the opportunity to purchase bonds in an amount of \$5million in \$1,000 denominations).

There are 33 proposed amendments to the existing license, 19 of which have been suggested by Cablevision and 14 by the City. Cablevision's proposals generally lessen the company's current financial obligations. At the same time, some of Cablevision's suggestions recognize technical changes or the lessening of service requirements which have not been actively sought by consumers. The

City authored changes were written to tighten up the license in customer service areas and improve the City's ability to monitor the contract. City officials are also demanding a low cost basic service for low income residents.

The amendment which saves Cablevision the most money is its new agreement with the Access Foundation. Under the original license, Cablevision was to pay 5% of gross revenues to the Access Foundation. The new agreement, to be incorporated into the license, substantially reduces Cablevision's financial commitment to the Access Foundation. Currently payments are \$42,000 per month. They increase to \$45,833 per month on July 1, 1987 and \$50,000 per month on July 1, 1988 for the duration of the license with a Consumer Price Index (CPI) provision beginning in 1989. There is also a \$50,000 payment for rent and maintenance of the Roxbury studio. Effective July 1, 1989 there is a provision for the Access Foundation to receive additional payments of 5% of Cablevision's first \$10 million of net revenue. However, net revenue is defined as gross revenue less debt service, operating expenses plus a compounded annual return on equity of 13% over the term of the agreement. Using the 1986 10K, the Access Foundation would receive nothing from such a provision.

The amended deal has significant financial benefits for Cablevision. During 1986, for example, Cablevision made \$30,000 payments for two months and \$42,000 monthly payments the rest of the year. A \$450,000 rent payment and maintenance charges resulted in a \$530,000 total payment. At 5% of gross revenues, Cablevision would have paid approximately \$1.1 million. The company saved in the area of \$570,000 in that year alone. Gross revenues have increased and will increase annually. The amended agreement with the Foundation will conservatively save the company between \$8-12 million over the remaining years of the license.

There are other cost savings to the company via the proposed amendments.

- 1 - Building three distribution centers instead of four;
- 2 - Having nine as opposed to 12 satellite earth stations;
- 3 - Offering only pay-per-view as an interactive service and waiving liquidated damage requirements;
- 4 - Building but one neighborhood access studio as opposed to the three required by the license;
- 5 - Reducing its commitment to construct municipal channels;
- 6 - Lessening PIN connection requirements; a schedule is to be set annually. A part of the agreement with the Access Foundation calls for only a maximum of \$50,000 in annual PIN connection costs or else it loses a \$100,000 payment from Cablevision to assist it on PIN connects;
- 7 - Defer all interest on franchise fee payments which would amount to a minimum of \$300,000.

It is difficult to put a price tag on the dollar savings to Cablevision if all the amendments are incorporated into the agreement. But collectively they save the company a substantial sum of money. Building only one access studio as opposed to three has the one times savings on equipment of \$400,000 to \$500,000, plus any replacement costs needed and leased studio space through 1997. Eliminating the construction of one hub distribution center and three satellite earth stations saves the company money as do the lessening of requirements for interactive services and municipal services. Cablevision is saving a considerable amount from what it contractually agreed to do in terms of performance. In addition, the City has not enforced any of the numerous financial penalties due to nonperformance.

The City proposed amendments improve its ability to manage the agreement, however, many are necessary due to Cablevision not performing well in customer service areas. The only amendment which carries a cost is the low cost low income basic service.

VI. CONCLUSIONS

Cablevision has repeatedly violated many of the provisions of its license with the City. The company was granted the license mainly due to the provision of a low cost Basic service, 52 channel programming on Basic and the commitment to the local access foundation. It is obvious that Cablevision bid low in order to obtain the license. The company agreed to a detailed and comprehensive license that it could not fulfill. Cablevision had management problems, especially in its marketing and customer service areas. When an accelerated construction schedule did not bring about the anticipated cash flow the company found itself in some financial difficulty. It halted construction and began to cut costs in other areas. It has had longstanding problems in the management of its customer service operation. It changed the programming offered on Basic and then increased rates.

Cablevision General Partner Charles Dolan, in his letter to the City seeking a lessening of license requirements, wrote that he believed that Cablevision's original promises remain unbroken by any practical measure. Not only is such a claim misleading but it is the type of statement that should cause City officials to be very careful in negotiating the amendments.

Despite what Dolan claims, Cablevision has a documented history of straying from its commitments to the City. It tried to reduce levels of programming in its very first year of operation. It continually failed to meet the terms of its agreements to support the Access Foundation and drastically cut

its annual financial obligations to the Foundation. It did not comply with its own stated plans to finance the system. It cut back on programming after the third year and increased the cost of Basic service after year four. Although its customer service management is showing signs of improvement, it has been a disaster for City residents since year one of the license.

It seems to the Commission that City officials must insist on a level of performance that was agreed to by the company. The documented lack of such performance over the years concerns us because of the likelihood that amendments to the license will not necessarily improve performance. Boston subscribers deserve better treatment from the company and also deserve a more aggressive effort on the part of city officials in demanding that performance. The Boston consumer is not benefitting from the award of this license in the manner intended. The original \$2 basic fee has been increased to \$6.25 and effective January 1, 1988 will be \$12.50.

The past performance of Cablevision must be the basis upon which the City approves any amendments. Cablevision cites financial woes as the reason for its lack of compliance with the license. It also maintains that the City must recognize the realities of the cable industry and that certain services called for in the license are not practical. There are legitimate reasons to amend the license. Cablevision does have some financial problems albeit of its own making. The industry has changed and certain services which were anticipated to be marketable have not turned out that way. Programming costs have gone up and at some point the consumer assumes the burden of those costs. But the City administration must keep in mind that Cablevision has agreed to do things in the past and not complied. Amendments must be consistent with the original license especially in the retention of a low cost basic service for City residents. It is also essential for the City to enforce the license whether or not it is amended.

Despite all of the problems associated with Cablevision since the issuance of the license, the Finance Commission believes that the City should continue to work with the company. Cable service is something that thousands of residents want and enjoy. The system being put in by Cablevision is technically sound, in the opinion of City officials, and thousands of consumers are satisfied with it. We do not believe that consideration should be given, at the present time, to license revocation. There is reason for optimism over the next year if acceptable amendments are negotiated. The number of subscribers is over 71,000 in Boston. The average monthly fee being paid by those customers is \$28-29. The company has just put in a new telephone system and, over the past week, we have noticed a reduction in the waiting time to get through to customer service representatives. However, the City must begin to thoroughly document any provision of the license which is not being complied with by Cablevision. The City would then be prepared, if performance was unsatisfactory, to proceed with license revocation and bring in another cable operator.

VIII RECOMMENDATIONS

The Finance Commission has reviewed every proposed amendment and, with some modifications, recommends that they be approved. Cablevision officials argue that they need some financial relief and Charles Dolan, in his request to have some changes made, argued that the changes are unavoidable for residents to have a satisfactory level of cable service. It is essential, however, for the City to extract a quid pro quo. The substantial financial savings that accrue to the company must be offset by some benefits to cable consumers. Moreover, the Boston taxpayer cannot be expected to finance any amendments.

One of Charles Dolan's recommendations to the city in suggesting the

amendments was that, "an effort be made to perpetuate low cost basic service to accomplish the City's original goals for cable television. We suggest that Boston's Basic Service be refined closer to its traditional concept." Despite that, Cablevision has informed the City that it will eliminate Basic Service to all consumers effective January 1, 1988. That is not acceptable.

Our recommendations are as follows:

1. The number one issue is completing construction of the system and treating those residents in unbuilt neighborhoods in a fair manner. The Back Bay, Bay Village and Chinatown should be completed by the end of 1987 and Beacon Hill by September of 1988. Residents in those neighborhoods and in the many so-called dead spots must not be considered as new customers. They are people who could have purchased basic service, at the lowest rate, had Cablevision complied with the agreed upon construction schedule. It is therefore incumbent on the City to insist that Cablevision offer them the opportunity to purchase Basic cable service at the cost other customers are charged;

2. As an incentive to complete construction and respond to the City's willingness to lessen the financial obligations of the company, Cablevision should agree to freeze all rates for all subscribers city-wide until construction of the Back Bay, Bay Village, Chinatown and Beacon Hill is complete. Sufficient language should be included to have Cablevision waive the provisions of the Federal Cable Communications Act;

3. Cablevision must reverse its decision to eliminate Basic Service to all subscribers effective January 1, 1988. A low-cost Basic Service was the most important provision of the license. The City cannot agree to provide financial concessions to Cablevision without insisting upon the retention of Basic cable service at an affordable rate;

4. The deferral of paying 2/3rds of the franchise fee as a way of improving cash flow should be approved by the City. However, interest must be charged for what is essentially a loan to the company. The proposed amendment provides for no interest payments. The Commission recommends that Cablevision pay an amount equal to 1% of gross revenues for the years 1986, 1987, and 1988. It should be allowed to defer payment of an amount equal to 2% of gross revenues until January 1, 1989. Interest should be assessed on any outstanding fees owed dating back to January 1, 1986 and extending through 1988. The unpaid portion of the fee should be transferred to a financial note, the nature of which shall be approved by the City. There should be no consideration given to repayment being connected with penetration rates or any other standard.

5. The license should be amended to incorporate the provisions of the Attorney General's Assurance of Discontinuance concerning Cablevision's service practices and procedures, and Cablevision should be put on notice by the City that continued violations of these provisions shall be considered grounds for the city to invoke remedies available to it under the License.

6. Cablevision shall be required to submit to the City a detailed financial plan setting forth in detail its anticipated budget projections for the next five years and the specific financial resources available to it to meet these projections. The City should request, and Cablevision should be obligated to provide, detailed financial backup in order to document and verify this information.

7. The city should put Cablevision on notice as part of the amendment process that if it violates the terms of any of these amendments, or persists in violations of the original provisions, that the City will promptly enforce one or more of the following remedies available to it under the license in order to redress these violations:

(a) Recover against the \$2,000,000 performance bond posted by Cablevision for noncompliance with the License or nonpayment of taxes (License, Section 9.1 (iii));

(b) Recover against the irrevocable \$50,000 letter credit for nonpayment of the License Fee or damages for other noncompliance with the License (Section 9.1 (iv));

(c) Demand from Cablevision payment of liquidated damages for failure to comply with certain provisions of the License relating to completion of construction and installation and other matters (Section 14.14);

(d) Sue for monetary damages or specific performance of License provisions (Section 14.16); and

(e) Revoke the License (Section 14.15).

The Commission concluded that the remaining amendments should be adopted, as long as they are accompanied by amendments incorporating all of the above-mentioned benefits to Boston's cable subscribers. In this way Cablevision may be afforded some relief from its present financial plight, while at the same time the citizens of Boston would receive protections against a repeat of the pattern of violations during the past five years. This blend, if vigilantly enforced by the City, should benefit both Cablevision and the citizens of Boston whom it serves.

